MAJOR INTERNATIONAL TAX REFORM IN ISRAEL – PROPOSAL TAKES AIM AT TAX RESIDENCE RULES

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Tags
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INTRODUCTION

In November 2021, the Israel Tax Authority ("the I.T.A.") Committee for International Tax Reform ("the Committee") published a report ("the Report") proposing substantial reform to international tax rules in Israel. While time has passed without the enactment of enabling legislation, the establishment of a steady government in Israel suggests that the likelihood of enactment may occur in 2023. Contributing to this view is the favorable consensus to the recommendations among members of the Israeli bar and accountants that practice in the area. This comes as no surprise as members of the Israel Bar Association and the Institute of Certified Public Accountants actively participated in compiling the report.

The Committee recommends significant changes regarding various provisions under the Income Tax Ordinance [New Version] 5721-1961 ("the Ordinance"). These include, *inter alia*, the definition of tax residence, exit tax, and foreign tax credit. The declared aims of the Report are an increase in transparency, the prevention of double taxation, and the adoption of enforcement tools to attack aggressive tax planning and money laundering.

This article focuses on recommendations relating to the definitions of tax residence and nonresidence covered by the Report.

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TAX RESIDENCE RULES UNDER CURRENT LAW

Under existing law, tax residents of Israel are taxed based on worldwide income and gains. For this purpose, an individual is considered to be a resident of Israel if the facts indicate that his or her center of life is in Israel. An individual's center of life is in Israel based on the existence of ties to Israel, such as family, business, investments, and social activity. A rebuttable assumption of residence exists if an individual spends 183 days or more in Israel in one tax year, typically the calendar year. A separate rebuttable presumption exists if an individual spends 30 days in Israel in one tax year and 425 days over three consecutive tax years. including the year in examination. Individuals who believe their facts overcome the rebuttable presumption of residency must submit reports that identify the reasons supporting the conclusion as to nonresidence.

Administrative problems were regularly encountered with the two rebuttable presumptions and the application of the center of life test. Individuals regularly contended that their particular facts overcame the rebuttable presumption, while the I.T.A on the other hand ignored having the individual spend less time in Israel than the refutable number of days, claiming that the individual's center of life was in Israel. Fact patterns needed to be examined on a case-by-case basis, based on specific

circumstances, facts, and evidence, often leading to inconsistent results and lack of clarity to taxpayers. Two cases demonstrate the fact finding that is required of an individual who challenges the presumption. In one case, the individual did his homework; in the other, significantly fewer facts were given and the result differed.

The first case is *Kfar Saba Assessing Officer v. Michael Sapir*.[1] There, an Israeli citizen, Mr. Sapir, moved to Singapore in 1994 with his wife and family. He, his wife, and his family returned to Israel in 1998. Then, in 2001, Mr. Sapir returned to Singapore. This time, his wife and children remained in Israel.

Mr. Sapir filed Israeli annual income tax reports but did not include his income in Singapore. The I.T.A. assessed tax on the worldwide income of Mr. Sapir, contending that he never relinquished Israeli residence. Among other justifications given was the location of his family in Israel.

The Tel Aviv District Court held that Mr. Sapir's center of life was in Singapore during his time of presence there. Important factual indicators were as follows:

- His ownership of an apartment in Singapore which served as his permanent home
- His permanent residence permit in Singapore
- Payments he made to a Singapore retirement fund, Singapore medical insurance policy, and other insurance coverage in Singapore
- The maintenance of a bank account in Singapore
- His social ties in Singapore
- His tax status in Singapore as a resident[2]

The Supreme Court dismissed the appeal filed by the I.T.A. explaining that a married couple may have different centers of life.

The second case is *Rafaeli v. Kfar Saba Assessing Officer*.[3] There, the individual was a super model, Bar Rafaeli. The years in issue were 2009 and 2010. The rebuttable presumption did not apply to the latter year because the requisite number of days spent in Israel was not met. That was not an impediment because the presumption favors the I.T.A. in that assuming no set of facts other than day count are found to be controlling, the presumption of residence applies based on the center of life test.

In broad terms, the relevant facts for and against residence were as follows:

- For nonresident status in Israel:
    - The individual had a relationship with the actor Leonardo DiCaprio, with whom she claimed to have lived while in the U.S. in California and New York.

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1 CA 4862/13 (March 20, 2014).

2 Singapore has a territorial tax system which limits the tax base to income arising from sources in Singapore.

3 AA 6418-02-16 (April 11, 2019).

- For resident status in Israel:
    - The individual came to Israel in the relevant years between 14 and 15 times each year for periods of 10-12 days on average each time.
    - Many of the trips to Israel coincided with family holidays and events and festivities.
    - The lend-a-star companies formed abroad that received her income and made investments on her behalf were managed and controlled in Israel, making them Israeli tax resident companies, a contact with Israel.
    - The individual did not indicate another country in which she was a resident for tax purposes under the laws of that country.
    - On a tax form in the U.S., the individual indicated that she was an Israeli resident for tax purposes.

The court determined that in both years, the individual's center of life was in Israel, where she had family ties and material connections.

"The Report proposes the adoption of a day-count system for an individual to be classified irrefutably as an Israeli resident for tax purposes."

TAX RESIDENCE UNDER RULES IN THE REPORT

Irrebuttable Classification as an Israeli Resident

The Report proposes the adoption of a day-count system for an individual to be classified irrefutably as an Israeli resident for tax purposes. If any of the following three tests are met, the individual would be considered a tax resident of Israel:

- An individual who is present in Israel for at least 183 days in each of two consecutive tax years.
- An individual who is present in Israel for at least 100 days in a tax year and at least 450 days over the three preceding tax years. This presumption will not apply if (i) the individual is physically present for at least 183 days in a foreign country, (ii) an income tax treaty is in effect between that foreign country and Israel, and (iii) the individual obtains a certificate of residency from the tax authority of that country.
- An individual that is present in Israel at least 100 days in a tax year when that person's spouse is an Israeli tax resident. For this purpose, the same rule applies if the individual shares a common household with a person that is not a spouse.

Irrebuttable Classification as a Foreign Resident

The Report also proposes the adoption of a day-count system for an individual to be classified irrefutably as a nonresident for tax purposes with regard to Israel. If any of the following tests are met, the individual would not be considered a tax resident of Israel:

- **An individual who is present in Israel for less than 30 days during a tax year for four consecutive tax years.** Here, the individual will be classified as a foreign resident as of the first day of the first year in the four-year period. This rule will not apply if the individual is present in Israel for more than 15 days (i) in the first month of the first year in the four-year period or (ii) in the last month of the last year in the four-year period.

- **An individual who is present in Israel less than 30 days during a tax year for three consecutive tax years.** Here, the individual will be classified as a foreign resident as of the first day of the second tax year in the three-year period. Again, this rule will not apply if the individual is present in Israel for more than 15 days (i) in the first month of the first year in the three-year period or (ii) in the last month of the last year in the three-year period.

- **An individual and spouse who are present in Israel for less than 60 days during a tax year for four consecutive tax years.** Here, both will be classified as foreign residents as of the first day of the first tax year in the four-year period. This rule will not apply if either the individual or the spouse is present in Israel for more than 30 days (i) in the first month of the first year in the four-year period or (ii) in the last month of the last year in the four-year period.

- **An individual and spouse who are present in Israel for less than 60 days during a tax year for three consecutive tax years.** Here, both will be classified as foreign residents as of the first day of the second tax year. This rule will not apply if either the individual or the spouse is present in Israel for more than 30 days (i) in the first month of the first year in the four-year period or (ii) in the last month of the last year in the three-year period.

- **An individual and spouse who (i) are present in Israel for less than 100 days each year for four consecutive tax years, (ii) are present for at least 183 days in a foreign country with which Israel has in effect an income tax treaty, and (iii) hold a residency certificate from the treaty partner foreign country.** Here, both will be classified as foreign residents as of the first day of the first tax year in the four-year period. This rule will not apply if the either the individual or the spouse is present in Israel for more than 50 days (i) in the first 100 days of the first year in the four-year period or (ii) in the last month of the last year in the four-year period.

- **An individual and spouse who (i) are present in Israel for less than 100 days each year for three consecutive tax years, (ii) are present for at least 183 days in a foreign country with which Israel has in effect an income tax treaty, and (iii) hold a residency certificate from the treaty partner foreign country.** Here, both will be classified as foreign residents as of the first day of the second tax year in the four-year period. This rule will not apply if the either the individual or the spouse is present in Israel for more than 50 days (i) in the first 100 days of the first year in the three-year period or (ii) in the last month of the last year in the three-year period.

The Center of Life Test

The test based on center of life factors will continue to apply in all fact patterns that are not controlled by the irrebuttable presumptions of residence or nonresidence in Israel.

CONCLUSION

While the aim of the Report was to simplify the residence test in order to create much needed certainty for taxpayers and the I.T.A., it is not clear that the method proposed will achieve its goal.

Yes, individuals who cross the irrebuttable rules of residence will no longer be able to challenge the I.T.A. in court. Yes, the I.T.A. will not be able to challenge the non-resident status of an individual who resides in a treaty partner country, is present in that country for at least 183 days, and has a residence certificate issued by the country's tax administration.

That leaves everyone else having contacts with Israel and another country. For those individuals having facts that do not fit squarely within a presumption of residence or nonresidence, the facts and circumstances will continue to be examined in order to identify the center of life for an individual. More importantly, by eliminating cases at the fringes that should never have been brought because the individual clearly was a resident, as in the *Rafaeli* case, or clearly was a nonresident, as in the Sapir case, the I.T.A. can better direct its attention to the broad class of individuals having some contacts in Israel and other contacts abroad. The only certainty that these individuals will have is that the I.T.A. will be less resource-bound when reviewing claims of nonresidence.

Finally, the Report did not address specific circumstances relating to cultural changes in the work environment as a result of COVID-19. The concept of digital nomads, frontier workers, and remote workers are not addressed.